

L. R. B. & M. JOURNAL

VOLUME 5

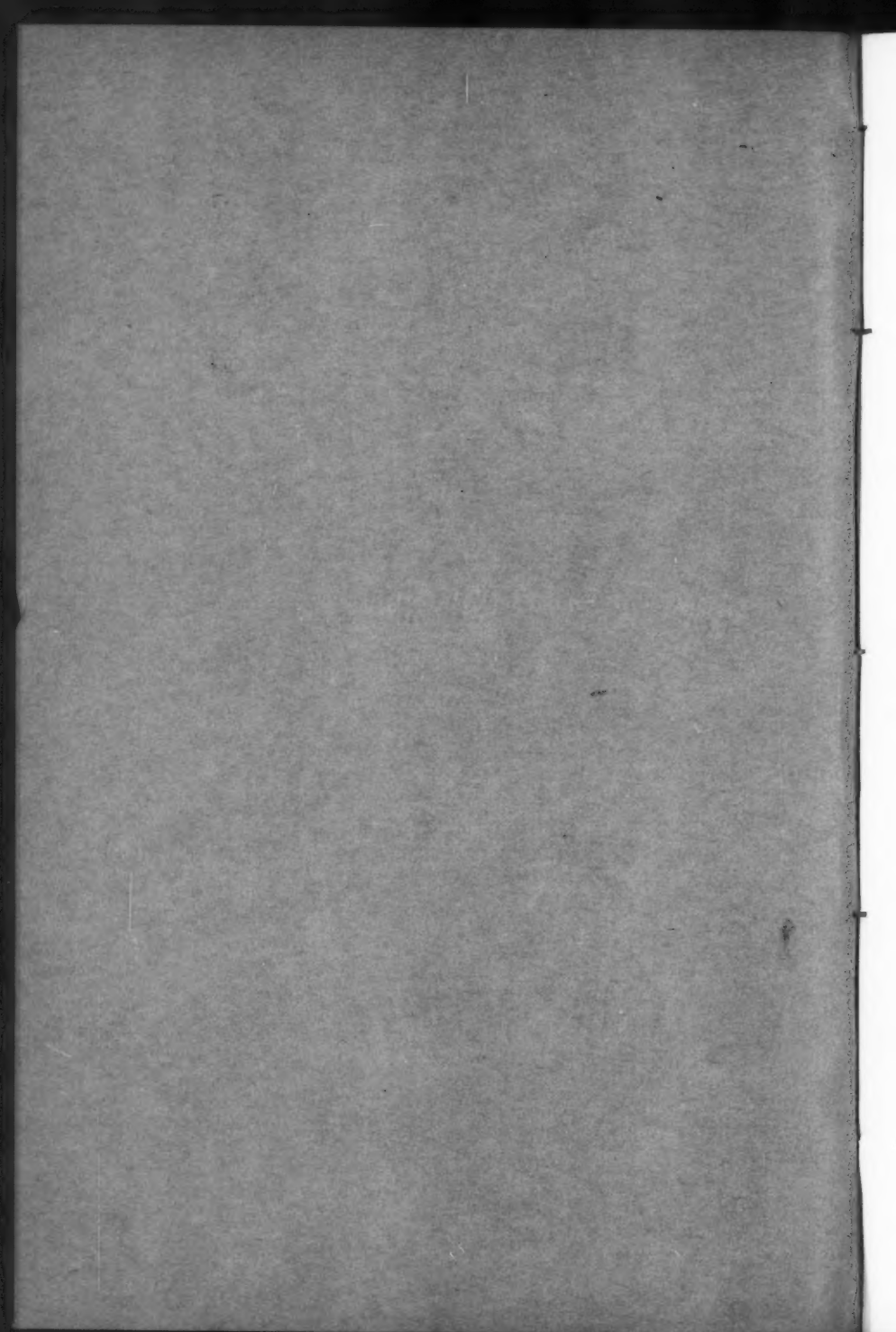
NUMBER 5

MAY, 1924

Published by

LYBRAND, ROSS BROS. & MONTGOMERY

Accountants and Auditors



L. R. B. & M. JOURNAL

VOLUME FIVE

MAY, 1924

NUMBER FIVE

How Tax Laws Are Made

By ROBERT BUCHANAN

San Francisco Office

Nearly all of the comment on tax legislation comes after the more or less iniquitous law is enacted. Many of the opinions now being handed down by the Federal courts deal with the legislative intent of Congress, particularly the intent back of the laws which were enacted during a period of great emergency—at the white heat of war—when the conditions influencing the legislators were certainly much different from reconstruction or peacetime conditions. It is also to be noted from recent decisions that attempts are being made, both by the Government and by the taxpayer, to interpret earlier tax laws in the light of subsequent legislation. As was said by Judge Mayer of the Circuit Court in a recent case (*Douglas v. Edwards*):

It is an accepted principle that for purposes of statutory construction, within certain limits, resort may be had to subsequent statutes.

Availing of this principle, the parties each seek comfort in the Revenue Act of 1918.

The great question is whether the subsequent law is an approval of the prior principle or a statement of a new rule.

Methods of Studying Tax Law-making:

To reverse the process, then, and to get back of the scenes, as it were, when a tax law is in the making, resort may be had to two processes:

- (1) A study may be made of the debates of the legislative body, statements of experts and others before the legislative committees both for and against the particular provision discussed, and the legislative history of the bill with respect to changes made at various stages of the progress of the bill.

- (2) Participation in an advisory capacity in the drafting of the laws or regulations and forms for the administration of the Act.

It is surprising how much light is thrown on the subject by such an intensive study as is indicated in (1) above. For example, Section 206 of the 1918 Act provided a method of computing the tax "whenever parts of a taxpayer's income are subject to rates for different calendar years" by placing the income applicable to the preceding year in the higher tax brackets. This provision was left out of the 1921 Act. It is found again in Section 207 (b) of the proposed 1924 Act. The explanation is made by A. W. Gregg, special assistant to Secretary Mellon, that:

The second sentence of subdivision (b) of this section is similar to Section 206 of the Revenue Act of 1918, which was inadvertently omitted from the Revenue Act of 1921. The provision is necessary for the computation in fiscal year cases and is, therefore, restored in the draft.

It would appear that someone snipped the scissors on Section 206 of the 1918 Act and forgot to paste it in the draft of the 1921 Act.

Inherent Evidence of What Tax Laws Mean:

Again, in the *Douglas v. Edwards* case mentioned above, referring to the rule for taxing dividends, the court quotes part of Section 201 (d) of the 1918 Act. That subdivision applied a special rule for taxing stock dividends. Since the Supreme Court subsequently held stock dividends were not taxable, Section 201 (d), of course, is of no effect.

The same court with reference to taxation of dividends also quoted Section 201 (e) of the 1918 Act, which states the rule that dividends paid in the first sixty days of the taxable year are deemed to be made from profits accumulated during preceding taxable years. This subdivision, however, is applicable only to the computation of invested capital (Sol. Op. 140, and Art. 858, Reg. 62).

In short, it is believed that if the court had examined the history of the two provisions mentioned above, it would have concluded that they were specially drafted to cover the special cases of stock dividends, and invested capital, respectively, and not the method of taxing ordinary dividends.

Explanation by Treasury Experts:

An example of the advisability of knowing something of the manner in which tax laws are made is found by considering Section 204 (a) (6) of the proposed 1924 Act, which as it appeared in the Mellon draft reads as follows:

If the property (other than stock or securities in a corporation a party to the reorganization) was acquired after February 28, 1913, by a corporation in connection with a reorganization, and an interest or control in such property of eighty per centum or more remained in the same persons or any of them, then the basis shall, notwithstanding the provisions of paragraph (5) of this subdivision, be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

The above quoted provision is one sentence containing over one hundred and ten words—more than two ordinary night letters. Try to say it in one breath! If Mr. Gregg wrote it, I would say he was afflicted with the virus that attacked Henry James. And remember that there are dozens of sentences in the proposed law just as involved as the one quoted above. In fact, some of these

involutions remind one of Wakefield of the Boston office at his best—when, for instance, he is discussing whether the sales proceeds should be compared both with depreciated cost and with depreciated March 1, 1913, value to determine if there is gain or loss. Never having entered the hallowed walls of Harvard, I am unable to say whether they teach the students there these involved periods or whether it is absorbed from the cultural atmosphere. One might imagine Mr. Gregg also had emerged from Harvard until you read his explanation of the above quoted provision in the following clear and simple language: "

There is no provision of the existing law which corresponds to paragraph (6) of the draft. This paragraph provides that where in connection with a reorganization assets are transferred from one corporation to another, the assets so transferred shall retain the same basis in the hands of the new corporation as they had in the hands of the old corporation. The application of this paragraph is limited to the cases in which an interest or control in the assets so transferred of 80 per centum or more remains in the same persons.

Under the existing law, if the A corporation owns assets which cost it \$10,000 but which are now worth \$20,000, it can reorganize into the B corporation, exchanging shares of stock of the B corporation for the shares of stock of the A corporation. Neither corporation A nor its stockholders realize any taxable gain from the reorganization. The B corporation, however, can set up the assets received in the reorganization on its books at their market value, that is, \$20,000, and use that amount as the basis for determining the gain or loss from the subsequent sale of the assets and for determining depreciation and depletion. Under paragraph (6) of the draft, however, corporation B must set up the assets on its books at \$10,000, their basis in the hands of corporation A, and must use that amount as the basis for determining the gain or loss from the subsequent sale of the assets and for determining depreciation and depletion.

Section 203 of the draft provides that the gain or loss from exchanges made in connection with the reorganization, whether the exchange is made by the corporation a party to the reorganization or by the stockholders of such corporation, shall not be recognized. The theory underlying the provisions of this section is that the new corporation, that is, the reorganized corporation, is as a matter of fact the same as the old corporation, and that in substance there has been no real

change which would result in a realization of profit by the corporations or by their stockholders. The same theory should be applied in determining the basis of the assets transferred in connection with the reorganization. If the new corporation is in substance the same as the old, the basis for determining gain or loss and for depreciation and depletion of the assets of the new corporation should be the same as the basis of those assets in the hands of the old corporation prior to the exchange. The provisions of this paragraph limiting the basis of the assets transferred in connection with the reorganization to the basis in the hands of the transferor represent the logical counterpart of the provisions of Section 203 which exempt from tax exchanges made in connection with a reorganization.

The application of this paragraph is limited, however, to those cases in which the new corporation is substantially the same as the old; that is, to the cases in which an interest or control of 80 per centum in the two corporations remains in the same persons.

The following amendment has been added in the Senate draft:

This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

Evidently the meaning previously was not clear, because in Senator Smoot's report dated April 10, 1924 (p. 18), explaining this, it is stated:

The changes in the verbiage of this and the two succeeding paragraphs are designed to clarify the provisions of the House bill and to show clearly that the types of transactions described in paragraphs (7) and (8), even though the particular transaction because of the date of its occurrence or for some other reason may not be within the provisions of such paragraph, are not within the provisions of paragraph (6) and are not subject to rules laid down therein.

And a little further on, dealing with the same subject, it is stated:

The purpose of this and the succeeding paragraph is to check evasions.

Thus it can be seen that the motives actuating the legislators, and the purposes sought to be accomplished by certain provisions can sometimes be traced step by step through the processes by which the bill is moulded

finally into the formidable statute which is so hard to understand from a formal reading of its terms.

The Making of State Tax Laws:

The National Tax Association has drafted two model laws for the aid and comfort of state legislatures desiring to enact an income tax law. One of these models is designed as a purely personal income tax law applicable to individuals, partnerships, estates and trusts. The other is applicable to corporations doing business within the state.

The State of Oregon when it enacted an income tax law in 1923 attempted to consolidate these two model laws into one act with some curious results. The writer, for the firm, assisted in drafting the regulations for the Oregon State Tax Commission. It was found on a study of the Act, that Section 4 (b) provided for the imposition of the tax on:

The net income received during the income year by deceased individuals who at the time of death were residents and who have died on or after April 15th of the tax year without having made a return.

One attorney expressed the opinion publicly that if a person died before April 15th without having made a return, his income to the date of his death was not taxable. An examination of the model law disclosed the fact that returns under the model were due April 15th, and, of course, it was assumed that an individual alive at that date would already have made his return. In the Oregon law, the due date for filing returns (Section 17) was changed to 90 days after the close of the income year (approximately) without a corresponding change being made in Section 4 (b) above. By regulation (Art. 175) it was held in effect that a person cannot escape the tax by dying prior to April 15th.

Taxation of Non-residents Doing Business in the State:

The greatest difficulty in drafting the regulations arose over Section 7 (5), which reads:

The amount of the net income returned by a non-resident individual or corporation shall be that proportion of the taxpayer's total net income which the taxpayer's gross business done in the State of Oregon bears to the total business done by the taxpayer.

The law contained no definition of "gross business." A literal reading and application of the law might well drag into Oregon, income that was earned outside the state—for example, where an Oregon branch sustained a net loss, but the California business was very profitable. If a large proportion of the total gross business was done within Oregon, the arbitrary prorating method stated in Section 7 (a) would in such a case, subject the net income earned in California to the Oregon tax. By regulation a more equitable method of apportionment was adopted, following largely the basis used in the New York income tax law, so as to tax only the income arising in Oregon. Since these regulations were promulgated, most of the talk of attacking the constitutionality of the Act has ceased.

Fiscal Periods:

Recently the writer, for the firm, was asked to advise the State of Arkansas with reference to the income tax law recently enacted in that state. The Arkansas tax is based on gross income instead of net income and is levied in respect of the fiscal year ended March 31st. Since nearly all individuals report on a calendar year basis for Federal tax purposes, it is much simpler for the state to adopt that basis generally. In fact, the states could well follow the example of South Carolina, which, I

understand, has adopted the Federal income tax law for state purposes.

Assistance to Legislators:

It is the experience of the writer that legislators welcome constructive suggestions looking to simplification and clarification of the tax laws. So also do the administrative bodies in framing their regulations. Thus there is a real opportunity for accountants to render public service in this field because they can quickly show the taxing authorities, by concrete examples, how a proposed provision will work a hardship and how it may be made to apply equitably.

Can the Tax Laws be Made Simpler?

James M. Beck, in his recent lectures on the Constitution of the United States, says of the framing of that mighty document:

Nothing is more admirable than the self-restraint of men who, venturing upon an untried experiment, and after debating for four months upon the principles of government, were content to embody their conclusions in not more than 4,000 words.

Contrast the above with the 344 printed pages of the Mellon bill!

An editorial in the *Saturday Evening Post* of April 19, 1924, quotes Chairman Green of the Ways and Means Committee as follows:

All through the (present) bill you will find a system of allowances, deductions for depletions and for losses that are now being permitted to be carried over even into the third year, in order to equalize conditions with reference to the taxpayer and prevent the law from bearing too hard upon him in any particular year. All these provisions are just, and perhaps all of them are necessary, but every one tends to complicate the law. The complications that we have in the present law result from these numerous allowances and deductions, which are made all through the bill for equalization purposes, which are difficult to write and often very difficult to apply, but which on the whole tend to mitigate the condition of the taxpayer and to prevent the tax from imposing undue hardship upon him.

(Continued on page 7)

Comments on Stock Broker's Accounts

By LESTER E. NORRIS

New York Office

The article on "Stock Brokers' Accounts" which appeared in the March, 1924, issue of the L. R. B. & M. JOURNAL (being reprinted by permission from the February, 1924, *Pace Student*), contains the following introductory paragraph:

It should be borne in mind at the outset that this thesis is not intended to cover all phases of Stock Brokerage Accounting but is an attempt to outline only the essential features of a workable system.

In view of the excellence of Mr. Clayton's presentation of the subject and the amount of theory expressed in such limited space, the following comments are not submitted in a spirit of criticism. The writer of these comments believes, however, that there are some points therein which are subject either to correction or clarification.

Short Sales:

In defining a "short" transaction Mr. Clayton writes that

A sale is first made, and then the security necessary to fill the contract is purchased. The customer who "goes short" expects to profit by a fall in the market price of the security. He sells a stock that he does not own and agrees to deliver in 30, 60 or 90 days.

The writer believes that this definition should be clarified. It appears to cover only "buyers or sellers options" and does not fully apply to what is generally accepted in "Street" parlance as a "short trade." Under Article XXIII, Sec. 3, of the constitution of the New York Stock Exchange, the following classification is noted:

"Buyers or sellers options" for not less than four days nor more than sixty days. On such transactions written contracts are exchanged on the day following the transaction, and carry interest at the legal rate unless otherwise agreed; on these contracts one day's notice is

usually given, at or before 2:15 P. M. before the securities are delivered prior to the maturity of the contract.

These contracts are generally used when the security sold is possessed but is not available for immediate delivery, and most generally in the case of brokers doing business with clients in a foreign country. As a matter of fact, bonds are more generally dealt in on a contract basis than are stocks.

A "short sale," on the other hand, is not governed by any time limit but is merely made in anticipation of "covering," i. e., purchasing, at a lower price than the selling price, thus realizing a profit on the transaction.

Accounting Records:

Under this caption Mr. Clayton refers to the following records of original entry:

Journal
Cash Book
Blotter

The writer assumes that the cash book mentioned refers to the cash blotter and that the blotter referred to is the securities blotter, both of which records are generally used in "Street" houses. The old style cash book has long since been superseded and many "Street" houses have discarded the journal and pass *all* entries through the blotter, with the exception of private ledger entries which are not open to general inspection and are, therefore, passed through a private journal.

Mr. Clayton refers to a broker's controlling account being carried on the general ledger to provide for the recording of the balance arising from open trades with brokers. While the theory

expressed is correct, it is general practice to subdivide these accounts as follows:

Items failed to receive
Items failed to deliver
Stocks borrowed
Stocks loaned

These accounts are carried as separate classifications on the general ledger, controlling subsidiary records detailing the transactions.

Loan Ledger:

The writer does not agree with Mr. Clayton's conception of a loan ledger. Mr. Clayton states that:

A separate account may be kept with each lender or for each loan. The former is more practicable, as the broker ordinarily has a general balance with the lender instead of one or more specific loans. This general balance is expanded or contracted according to his needs, and this process is accompanied by the pledging of additional collateral or the redemption of collateral previously pledged, as the case may be. This method of dealing, therefore, tends to merge all loans into a general balance, instead of keeping intact the identity of each specific loan.

The average brokerage house in New York frequently has several loans with the same bank. Some of these loans are time loans and some are call loans.

It presents a clearer record to enter each loan and collateral therefor on a separate loan sheet or card. When a loan is paid off, the sheet or card may be stamped "paid" and removed from the book or card box, as the case may be. If the loans were consolidated into one amount on the records and the collateral "lumped," it would be but a short time, due to payments and renewals of loans and the numerous substitutions of collateral, before the consolidated record would become so cumbersome and involved with entries of cancellations and payments as to require considerable time to decipher it.

Position Book:

Mr. Clayton, in illustrating a "Position Book," is generally correct as to theory,

but he appears to have stressed the "long" position in the book and to have disregarded the "short" side. He also fails to state that most "Street" trades are made in the "regular way" for delivery by 2:15 P. M. upon the next full business day following the date of contract. There are, of course, some special contracts, which require consummation on the date of trade, but these instances are rare and a departure from the regular practice.

For the purpose of illustrating the writer's present conception of a position book, we first quote from Mr. Clayton's article as follows:

On January 1, 1922, the house inaugurated a new accounting system and installed among other records a Position Book. The inventory of securities and analysis of customers' accounts disclosed that 100 shares of Anaconda Copper were on hand, distributed as follows:

A. Andrews—Long—25 shares
B. Biddle —Long—50 shares
House —Long—25 shares

On January 2, the following transactions occurred:

Sold:

For account of Andrews, 25 shares to Jones & Company, Brokers.
For account of Biddle, 25 shares to Smith Bros., Brokers.
For account of Carson (short), 25 shares to Jones & Co., Brokers.

Bought:

For account of Dudley, 50 shares from Smith Bros., Brokers.
For account of Elwell, 100 shares from A. Adams, Brokers.

On January 3, the following:

The house borrowed from Williams & Company the 25 shares that Carson was short and delivered them to Jones & Company.

The house also delivered to brokers the stock sold by their other customers and received from brokers the stock purchased, the latter being forwarded to the Anaconda Copper Company for transfer.

On January 4:

The house received the new certificates from the Company and delivered 100 shares to Elwell, who paid the house.

As the writer understands the functions of a position book, the entries

therein, based on the above transactions, would have been as follows:

Position Book, Long Side
Anaconda Copper

	January, 1922			
	1	2	3	4
Andrews.....	25	25	..	..
Biddle.....	50	50	25	25
Firm.....	25	25	25	25
Elwell.....	..	..	100	..
Dudley.....	..	..	50	50
	100	100	200	100

Position Book, Short Side
Anaconda Copper

	January, 1922			
	1	2	3	4
Box.....	100	100	25	75
Carson.....	..	..	25	25
Transfer.....	..	..	150	..
	100	100	200	100

The foregoing position is based on the assumption that when the house took inventory on January 1, 1922, a holiday, the 100 shares of stock carried was lodged in the safe deposit box of the firm.

The trades of January 2d are all assumed to be "regular trades" which, in practice, would pass through the firm's books as of January 3d. The position book, therefore, on January 2d would still agree with the original inventory position. On January 3d, it will be noted, Andrews' position is eliminated by virtue of sale, Biddle's is reduced 25 shares for the same reason, the firm position remains the same, and Elwell and Dudley are shown long 100 and 50 shares, respectively, due to purchases. On the short side Carson's short sale is recorded, the box is reduced from 100 shares to 25 shares to cover the delivery of the 75 shares sold for account of Andrews, Biddle and Carson, and 150 shares are shown as being in transfer.

It will be noted that there was no necessity for borrowing 25 shares to make delivery of Carson's short trade, as

the firm had sufficient security in the box to handle the transaction without borrowing.

On January 4th the only change on the long side was the clearing of the 100 shares delivered to Elwell and paid for by him. On the short side 150 shares in transfer were received, canceling that item, and of these shares 100 were delivered to Elwell and 50 were deposited in the box, thus increasing that position.

The foregoing illustration records both long and short positions and the record is in balance each day.

Transactions covering stocks borrowed and loaned, failed to receive and deliver, hypothecated as collateral for loans, etc., would, of course, be recorded daily, and the aggregate of long and short sides would always be in balance if the entries were properly made.

The suggestions offered in this article are made on the assumption that the house doing a brokerage business is governed by the rules of the New York Stock Exchange.

How Tax Laws Are Made

(Continued from page 4)

The editorial then goes on:

Yet we find that every time the revenue measure is amended by Congress efforts are made to increase vastly its complexity by adding new deductions or exemptions and requiring still further details from the taxpayer, even to the extent of demanding that he rebate the amount of his contributions to political parties. It may appeal to our sympathies to allow extra exemptions for doctors' bills, nurses' fees and remote circles of doddering relations, but the Bureau of Internal Revenue is quite sufficiently burdened without being obliged to investigate the personal affairs of ten million families.

Perhaps the solution is to be found in Colonel Montgomery's suggestion that Congress declare a tax holiday for ten years—and make no further changes in the law until the expiration of that period.

The Revenue Act of 1924

By E. E. WAKEFIELD

Boston Office

The Revenue Act of 1924 is pending in Congress. What it will be when it finally emerges only a rash prophet would attempt to say. It seems quite probable that it will not be the "Mellon Bill" presented to the House Ways and Means Committee, now many weeks ago, as the Treasury plan for revision of the law. There are many things in the original draft of the bill and in the changes so far proposed by Republicans and Democrats which are of interest as possible modifications of the law, but which are still much in the class of things "important, if true." Among the proposed changes, a few that would, if enacted, have most effect on taxpayers in general, are the following:

Rates—Individuals

The Mellon bill proposes normal income tax rates of 3 per cent on the first \$4,000 above exemptions and credits, and 6 per cent on the excess over \$4,000. It proposes surtax rates beginning with 1 per cent on income from \$10,000 to \$12,000 and rising to a maximum of 25 per cent. The importance of the 25 per cent surtax rate, according to the advocates of the Mellon plan, is the possibility of drawing more capital into industry and production and away from non-taxable municipal investments by making the maximum rate low enough to leave an attractive net return after taxes. According to supporters of this plan, it is idle to reduce the rate to any maximum materially above 25 per cent, because it will still be more profitable for large investors to keep their holdings in non-taxable municipals and the number of incomes paying a high surtax rate is too small to give any large return from a

higher rate. The Simmons plan, adopted recently by the Senate, proposes a maximum surtax rate of 40% on income of \$500,000 or more. The normal rates adopted under this plan are 2% on income (over exemptions) up to \$4,000, 4% on the next \$4,000 of income and 6% above \$8,000.

The normal rates included in the Longworth or House bill are 2% on incomes (over exemption) up to \$4,000, 5% on the next \$4,000 of income, and 6% above \$8,000. The maximum surtax rate under the Longworth bill is 37½% on incomes of \$200,000 or more.

Normal and surtax rates are subject to so many variations in the course of the bill in Congress that it seems safe to say only that they are likely to be lower than the present rates.

Basis for Gain or Loss and Depreciation

Section 204 of the new bill, as reported to the Senate, would upset present procedure with reference to determination of gains or losses on sale of assets owned at March 1, 1913, as it provides for use of cost or fair market value as of March 1, 1913, whichever is greater. If this language is permitted to remain in the bill as finally passed, the result will be, as compared with the 1921 act, to reduce taxable gains when selling price is higher than March 1, 1913 value and this is higher than cost, but to increase losses over the amount under the present rule by permitting deduction for the whole loss represented by the decline from the March 1, 1913 value to selling price, even though cost is less than March 1, 1913 value.

The same section attempts to har-

monize determination of depreciation and depletion and determination of gains or losses on sales by providing in general that the basis for depreciation, obsolescence and depletion shall be the same as for the determination of gain or loss on sales.

Net Losses

Section 206 modifies somewhat the existing rule for determination of net losses. Such losses under this provision of the bill may now be applied against capital net gains only after the exhaustion of other income.

Capital Net Losses (Section 208)

An important feature of the Mellon bill and of the bill as passed by the House is the provision for limiting the benefit from capital net losses to $12\frac{1}{2}$ per cent of the loss. Under the present law capital net gains are segregated and, if the taxpayer so elects, are taxable at only $12\frac{1}{2}$ per cent. Capital losses, in excess of capital gains, are deductible from other income, thus reducing income otherwise subject to normal and surtax rates. If there are no capital gains in the year, the capital losses may be deducted in full from other income.

The new provision would require separate determination of the tax without deduction for capital net losses—i. e., losses on property held for more than two years; then the tax so determined would be reduced by $12\frac{1}{2}$ per cent of the capital net loss. The Senate Finance Committee, however, reported the bill without this new provision. Another change proposed by the House, but not approved by the Senate Finance Committee, is the exclusion from capital gains of gain or loss from the sale of stock received as a stock dividend, even though such stock has been held for more than two years.

Earned Income

A proposal in the new law, Section 209, is of great interest to small taxpayers. Under this change all income up to \$5,000 would, in any event, be considered earned income, and wages, salaries, professional fees and other compensation for personal services up to a total of \$20,000 (modified to \$10,000 in the Senate) may be considered earned income. The taxpayer would be given a credit against his tax computed in the ordinary way, for 25 per cent of such part of the tax as his earned income is of his total income. That is, if total income was \$10,000, earned income would be considered at least \$5,000 and there would be a credit for 25 per cent of one-half of the tax, giving a deduction of $12\frac{1}{2}$ per cent of the tax.

Limitation of Interest Paid and Losses

An indirect effort to reduce the effect on revenue of the existence of tax-exempt securities is found in Section 214 (c) of the bill as passed by the House. This provides that deductions for interest paid (except in the course of business) and losses on investments shall be limited to the excess of such interest paid and losses sustained over the interest received on non-taxable securities. Thus if the taxpayer paid \$5,000 interest on personal loans and suffered a loss of \$1,000 on sale of securities, making a total of \$6,000, and received \$5,000 from non-taxable bonds, he would have a deduction from other income of only \$1,000. The Senate Finance Committee eliminated this provision and the Senate concurred in the elimination. There may be a question about the constitutionality of such a provision of the law on the ground that it is an indirect effort to tax so-called non-taxable interest, but this provision would not be different in principle from the previous limitations of in-

terest deductible, since in effect it would permit deduction of only a part of interest paid and it is not necessarily important how such limitation upon interest paid is fixed.

Revocable and Other Trusts

In the case of revocable trusts, revision of Section 219 of the law would require taxation of income of such trusts to the creator of the trust. At present such income is taxable to the beneficiary of the trust, who may or may not be the creator of the trust. The section would also require taxation to beneficiaries of income actually paid to beneficiaries under discretionary trusts. The latter provision seems a reasonable modification of the present law in accordance with the actual fact as to beneficial interest in the income.

Evasion of Surtax

Section 220 is made more effective, if the Department should attempt to enforce it, as it has not done so far, by providing that income subject to special tax of 25 per cent (to be increased to 50 per cent) shall include dividends. Under the present law, holding companies, in which earnings can be piled up from the business of active companies, cannot be effectively subjected to any penalty for failure to distribute surplus, because in so far as their income is derived from dividends, it is clear of the tax by the provisions of Section 234 (a) (6) allowing deduction from income for dividends received from domestic corporations.

Income on Annual Basis

Section 226 of the new law requires that income shall be placed on an annual basis only when there is a change of taxable period, and not whenever a return is made for less than a full year. Thus a return of a decedent from the beginning of the taxable year to the

date of his death would not have to be put on an annual basis. The credit for personal exemption would, however, be reduced to the same fraction of the full exemption that the taxable period is of twelve months.

Gift Tax

An entirely new attempt to reduce evasion of tax on income is introduced in the House bill in Sections 319 and following, under which gifts made on or after January 1, 1924, would be subjected to tax in accordance with the estate tax rates. No gifts of \$500 or less to any one person would be taxable, but larger gifts made during the year would be subject to tax upon the excess over \$50,000 (with some other exemptions). The Senate Finance Committee struck out this provision from the bill it reported to the Senate, but it was restored in modified form by the Senate.

Board of Tax Appeals

Section 900 of the bill provides for a Board of Tax Appeals of seven members, but temporarily a larger number not exceeding twenty-eight members, to be appointed by the President, by and with the advice and consent of the Senate, at a salary of \$7,500 (as amended in the Senate) per annum. The Board has jurisdiction for determination of questions on appeals from proposed additional assessments. Unfortunately it is given no jurisdiction in case of appeals from refusal of the Commissioner to allow abatements,* credits and refunds. It is to be hoped that this deficiency will be modified, because there are always bound to be very important questions of overassessment requiring

* Under Section 279 of the proposed 1924 Act "no claim in abatement shall be filed in respect to any assessment made after the enactment of this Act in respect of any income, war profits or excess profits tax."

refunds, as long as the method of determining the tax to be assessed in the Income Tax Unit remains subject to the present uncertainties and to the practice by internal revenue agents of giving the benefit of the doubt to the government and not to the taxpayer.

Publicity of Tax Returns

The Senate voted for complete publicity of tax returns, ignoring a carefully drawn provision in the revenue bill allowing for access to tax details only by authorized Congressional Committees. The Senate also adopted an amendment to give the public access to all claims for abatements or refunds of income tax payments and the subsequent decisions on such pleas.

Protest

A provision of Section 1014 of the bill is very welcome in that it would remove the question as to necessity for protest on payments of taxes in order to make suit possible. The language of the act is ". . . but such suit or proceeding may be maintained whether or not such tax, penalty, or sum has been paid under protest or duress." There is a possible question whether this provision, if enacted, would give the right to suit on payments made without protest before passage of the act, but it would seem to eliminate the question of need of protest under the new law, so that after the passage of the act it would not be necessary to assert payment under protest in any suit.

Corporation Income Taxes

The Senate has voted in favor of the Jones Amendment, under which there would be both a normal tax and a surtax, on corporations. The normal tax would be 9% on the entire taxable net

income. The surtax is a flat rate imposed on all "surtax net income" ("surtax net income" is the ordinary net income—no credits—plus dividends received and deducted from gross income) to the extent that the "surtax net income" becomes "undistributed net income." The latter is the amount by which the "surtax net income" exceeds the sum of (1) the amount of the normal tax for the taxable year, plus (2) the amount of cash dividends, including dividends paid in interest-bearing scrip if subject to tax in the hands of the distributees to the same extent as a dividend paid in cash, paid during the twelve months preceding the fifteenth day of the third month following the close of the taxable year, plus (3) amounts retained to replace capital losses sustained after the enactment of this Act, plus (4) amounts retained in compliance with law and the distribution of which is prohibited by law, plus (5) \$10,000.

The rate is dependent on the percentage which the amount of "undistributed net income" is of the amount of "surtax net income," and the appropriate tax rate applies to the *entire* "undistributed net income." If such percentage is 10% or less no surtax is imposed. The rates range from $\frac{1}{4}$ of 1% up to 40%.

Reduction of Tax on 1923 Income

There seems to be no doubt about the desire of all parties in Congress to get the political benefit of reduction of 25% on taxes upon income received in 1923. The actual process of bringing this about is so tied up with party politics and the strategy of procedure in this presidential year that it will not be wise for any of us to spend at present the one-quarter of the 1923 tax which may possibly be saved before the end of 1924.

(Continued on page 24)

The L. R. B. & M. Journal

Published by Lybrand, Ross Bros. and Montgomery, for free distribution to members and employees of the firm.

The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvement; to encourage and maintain a proper spirit of cooperation and interest and to help in the solution of common problems.

PARTNERS

WILLIAM M. LYBRAND	New York
T. EDWARD ROSS	Philadelphia
ADAM A. ROSS	Philadelphia
ROBERT H. MONTGOMERY	New York
JOSEPH M. PUGH	Philadelphia
WALTER A. STAUB	New York
H. H. DUMBRILLE	New York
JOHN HOOD, JR.	Philadelphia
WALTER S. GEE	New York
T. B. G. HENDERSON	Chicago
HOMER N. SWEET	Boston
GEORGE R. KEAST	San Francisco

OFFICES

NEW YORK	110 William Street
PHILADELPHIA	Morris Building
CHICAGO	Harris Trust Building
BOSTON	261 Franklin Street
PITTSBURGH	Union Bank Building
DETROIT	Book Building
CLEVELAND	Union Trust Building
CINCINNATI	414 Walnut Street
WASHINGTON	Union Trust Building
SAN FRANCISCO	2 Pine Street
LOS ANGELES	935 Valencia Street
SEATTLE	L. C. Smith Building
BALTIMORE	Citizens Bank Building

A Tax Number

In view of the present prominence of the income tax question in the Washington despatches, and minds of the public in general and of accountants and tax specialists in particular, we deem it appropriate that this issue be devoted largely to articles touching on phases of this pertinent subject.

Mr. Robert Buchanan, in charge of the tax departments of the Pacific coast

offices, has made the especially generous contribution of two articles. *How Tax Laws Are Made* relates some incidents which have occurred in the course of tax engagements, refers to some conclusions formed in the course of study of tax laws, and gives a glimpse of the important and interesting facts about the interpretation of tax laws to be discovered by investigating the circumstances attendant on their making.

Community Property in California deals with a tangled situation in California law, which has an important bearing on Federal income taxes. This subject is of great interest to taxpayers in the Western "community property states." As mentioned in the San Francisco office notes in this issue, Mr. Buchanan used the substance of this article in an address to the San Francisco Chapter of the National Association of Cost Accountants on April 25th. The article appeared in the *San Francisco Chronicle* of Sunday, May 4th, and is to be published in forthcoming numbers of the *Coast Banker*, *San Francisco Credit Men's Monthly* and in *Business*, a publication of the San Francisco Chamber of Commerce.

Mr. Wakefield of the Boston office has essayed a difficult task in discussing the pending Revenue Act of 1924, in that the proposed "Mellon Bill" and its proposed substitutes and amendments are being changed daily. It should be borne clearly in mind by readers of this article that the status of the proposed act may be entirely different, when this number of the JOURNAL emerges from the hands of the printers, from its status at the time the discussion was written. It is also well to remember that no attempt at prophecy is made in this article, since no one realizes better than does Mr. Wakefield the utter futility of any attempt to predict what the composite mind of Con-

gress will bring forth. The article merely aims to state those matters in the field of Federal income taxation which are receiving considerable attention at the present time.

Constructive Criticism

The article *Stock Brokers' Accounts*, which appeared in our March, 1924, number as a reprint from the February, 1924, *Pace Student*, has occasioned much comment among the brokerage men of the New York staff. This comment has been embodied in Mr. Lester E. Norris's article in the current issue, written for the purpose of correcting and clarifying a few of the points, with which Mr. Clayton dealt in only a general way, to accord with New York practice.

* * *

To Mr. Yardley of the Philadelphia office must be awarded the palm for being the only one, so far as we have heard, to find a discrepancy which appears in Mr. Spandau's article on *Typical Applications of Mathematics to Accounting* in the February number of the JOURNAL. Whether this means that no one else has read the article, or that no one else has been sufficiently well versed in mathematical intricacies to detect the discrepancy, is a matter of doubtful conjecture to us. We prefer to hold the latter supposition, which is more complimentary to Mr. Yardley, to Mr. Spandau, and to us—editorially speaking.

The part of the article to which exception is taken begins on the second column of page 15, whereon a problem is stated and its supposed solution set down. Mr. Yardley has noted that the solution does not fit the problem, and has sent the correct solution of the problem as stated. Mr. Spandau agrees with the correctness of Mr. Yardley's objection. However, he states that the error was not due to a misconception of the distinction between

an ordinary and a deferred annuity, but to an inadvertent misstatement of the problem in the process of trimming the article for publication.

A typographical error occurs on the same page, the amount of the down payment being mentioned as \$250,000 instead of \$100,000.

A Letter of Appreciation

In addition to many letters from individual partners of the firm of Haskins & Sells, following the publication of the editorial concerning Mr. Sells in the April JOURNAL, a letter of appreciation, which is reproduced below, was received from that firm:

The members of our firm to whom you sent copies of your April JOURNAL containing a tribute to our late Mr. Sells, and letters of sympathy, wish you to know how much they appreciate your reference to Mr. Sells and your thought of them. Your action makes us realize the more Mr. Sells' influence in developing in the profession a bond of fellowship conceived of things finer than the mere conventions of business contact. We thank you for your expression of sympathy and reciprocate to the fullest extent your feeling of cordiality.

Sincerely,

HASKINS & SELLS.

The Secret of His Success

He does what he thinks he ought to do. . . . Here is the finest instance in history of the success of moral power. . . . This is certain, that the eagerness of men to believe that pure, moral power carries empire with it is the reason why men study with personal interest the life and character of Washington. His success seems to give a warrant for the triumph of humanity. In his success men believe that they will not for any long time be given over to the sway of men who are merely intellectual tricksters or giants of physical force. Men agree to honor Washington, because in his life they think they have a demonstration that right is might.—
Edward Everett Hale,

Office Notes

CINCINNATI

The Cincinnati Office was favored on April 14th and 15th by a visit from Mr. Lybrand from New York and Mr. Henderson from Chicago. Fortunately, the weather man was fairly kind to us and we were in position on this account to show them around industrial Cincinnati and give them a good idea of our physical conditions, the magnitude of our industries, and the commercial importance of our location.

On Monday, April 14th, about twenty of the representative citizens of our city met at an informal luncheon given at the Business Men's Club, at which luncheon both Mr. Lybrand and Mr. Henderson were enabled to meet these citizens on a social rather than a business basis. Our only hope is that both Messrs. Lybrand and Henderson were as much impressed with our citizens as our citizens were with them.

On Tuesday evening, April 15th, our party, consisting of Messrs. Lybrand, Henderson, Guy and Peebles, were invited to attend the quarterly meeting of the Cincinnati Bar Association, given at the Gibson Hotel, at which time Mr. Lybrand was also invited to address the meeting. On account of the length of the program he was limited as to time for his remarks, but our local representatives were very much pleased with the manner in which he impressed upon the attorneys the importance of accountants and the legal profession working hand-in-hand, and the efforts being put forth in various localities, especially New York, to raise the standard of the accounting profession by passing legislation which would eventually result in weeding out all those who are not properly qualified and who are, by their lack of knowledge or by the conduct of their accounting

work, lowering the standard rather than assisting in placing it on the plane where it properly belongs.

On account of prior engagements it was necessary for Mr. Lybrand to leave the Bar Association meeting before its close, and he was thus able to meet personally only a few of our representative attorneys. This we regret, and trust that in the very near future he will be able to return to Cincinnati to begin his operations where he left off on this trip. We are unable to state how the other offices are affected by such visits, but in so far as we are concerned we feel that the visit of Messrs. Lybrand and Henderson, while a great pleasure to us personally, was also of inestimable value to the firm, and it is our hope that in the future such visits can be arranged more frequently. Such visits give our local business men to understand that the head offices of our firm appreciate the importance of Cincinnati as an industrial center and that they are giving the local activities personal attention. It is very natural that the Midwest towns appreciate their industrial importance and want this fact recognized by the outside world.

DETROIT

As soon as New York notified us that the notes for the May issue, "on sale at all news-stands" on June 1st, were due in New York on May 5th, we immediately called into consultation our old friend Herlock Combs, the great detective, and instructed him to delve into the private lives of the members of the staff and to report upon any items which would be of outstanding importance to the other offices. Imagine our surprise when his first report stated that five members of the staff, Messrs. O. I. Koke, R. I. Rose, L. L. Rose, W. G. Draewell

and O. T. Draewell, are sons of ministers. No wonder the Detroit office is so *good*! Owing to lack of time, however, he was unable to ascertain if they are like the proverbial ministers' sons. Our own observations would lead us to conclude they are not.

* * *

The vacation season has now arrived, the first one to be bitten by the "bug" being "Jack" Onslow, who left for his paternal home in South Carolina on April 25th. We thought that it would be a good idea to have a quartet bid him good-bye at the train, rendering with proper feeling, "Carolina in the Morning," but, since the best singer in the office had sprained his big toe, the plans were abandoned. Before "Jack" left, he told us confidentially that his mother had 32 spring chickens all fattened up, awaiting the arrival of the prodigal son. Words fail us!

* * *

Although we realize that one office should not knock another, we feel constrained to ask you, Mr. Editor, to delete from the notes received from Los Angeles and San Francisco any reference to their "wonderful" climate. If there is any truth in the statement that a man's outlook in life is influenced by the weather, the climate out there must be like their conversation concerning it—monotonous.

We also would like to comment on the Los Angeles statement in the March issue concerning the waving palms they have in their alleys. Suffice it to say that Detroit has "waving palms" also.

* * *

Genial H. J. Aughe has threatened ye editor with dire punishment if his name is mentioned in these notes. We feel, though, that we should broadcast to the other offices, who no doubt are on the

qui vive to learn what Dynamic Detroit is doing, the fact that Harry is now a radio bug. Every morning for about fifteen minutes he and Mr. Hyer get together and disturb the other members of the staff, who are trying to sleep, by talking about hook-ups, etc. Now, Harry, do your worst!

* * *

During the short visit which Mr. Lybrand accorded us last month we had an opportunity to see him in action. The address which he gave before the Detroit Chapter of the National Association of Cost Accountants on April 17 savored so much of an informal talk that it was very interesting. Reminiscences of his early experiences in the accounting profession as well as the few pointed remarks on the organization and purpose of the association merited and received the whole-hearted attention of everyone.

A visit such as this is very profitable to all members of the staff.

Mr. Editor! what would you tell the enterprising young junior who, at the close of Mr. Lybrand's talk, asked whether he should compliment Mr. Lybrand and say that he was proud of having such a man in our organization?

* * *

The following episode is vouched for by one member of the staff whose name we believe should not be mentioned:

Because the typewriter at the information desk was in poor condition, a repair man was summoned. When he arrived the office boy excitedly rushed into the typing department and said: "Say, if you want to see a 'cute' fellow you should see the man out here repairing the typewriter." At once, as if by command, four compacts were opened, four hands patted stray hairs into place, and four girls rushed out to see the "cute"

fellow who proved to be—colored. (Curtain.)

The girls in the typing department are complaining that they have been ignored in the office notes. We hope that the above episode will calm them; but because we know feminine nature we have our doubts.

* * *

Miss E. M. Buker is a new addition to our staff, acting at the present time as understudy to Miss Perkins, cashier. We hope that it will not be necessary to rebuker. (Cries of "Stop him!")

NEW YORK

The month of flowers finds members of the New York staff scattering into distant places. Two of the farthest flung of our coterie are Colquhoun, better known as "Cal," who is on an engagement in Texas, and Tom Inch, who, because of his excellent command of Spanish and his experience in accounting in Latin-American countries, has been assigned to a Cuban engagement.

* * *

Not to be outdone by staff members, two of our New York partners are taking extended trips. Mr. Lybrand is away for the month to visit the Pacific coast offices—Los Angeles, San Francisco and Seattle. Colonel Montgomery sailed for Europe on the Majestic on April 26th. He will return after a six weeks absence in quest of rest in Paris and southern France.

* * *

The silver tongued orator of the Cost Department, Mr. Archie F. Stock, addressed the Worcester Chapter of the National Association of Cost Accountants on the subject "Choosing the Proper Type of Cost System" on April 10th. Since Mr. Stock refuses to furnish further details, we are forced to

turn to the announcement of the meeting as follows:

Mr. Stock will need no introduction to those who have attended the National or Regional Meetings, as he has been very prominent at each.

Mr. Stock is manager of the Cost Accounting Department of Lybrand, Ross Bros. & Montgomery, and has installed cost and production systems in some of the largest concerns in the country. In addition to the knowledge which Mr. Stock has, he is an exceptionally fine speaker, and we are very fortunate in securing him for the meeting.

Mr. Stock is also scheduled to speak to the Worcester Chamber of Commerce on May 27th on "The Balance Sheet, Its Preparation and What the Banker Expects." He is also to summarize a series of talks on "Cost Finding," "Stock Keeping," "Inventory" and "General Accounting," which comprise a course that has been given recently for the manufacturing and mercantile executives of Worcester.

* * *

Mr. Myron B. Gordon, until recently a member of the Cost Accounting Department, has resigned to become Controller of the Seth Thomas Clock Co. "Mike" takes with him the good wishes of his many friends in this office.

* * *

The erstwhile Miss Kissinger and Mr. Bush, both of whom were rather heavily featured in this section of the April number, have returned from their *respective* honeymoons, having survived the early trials of married life and the relentless publicity accorded them by the JOURNAL. Mr. Bush reports a loud cry of protest from his bride, to whom he was incautious enough to show the schedule wherein she was classified as a liability.

* * *

Considerable curiosity has been aroused in this office lately as to the nature of the work of the Chicago office. Close on the heels of a request from Mr.

Henderson for information on the general economic possibilities of zinc, comes an inquiry from our JOURNAL correspondent about the accounts of cemeteries operated for profit. Such requests clearly indicate the diversity of the Chicago office's engagements. Incidentally, they also foster versatility in our unassigned men.

* * *

The editorial assistants in the New York office have long "turned the other cheek" to the persistent slaps of our Detroit correspondent on the chronic lateness of publication of the JOURNAL. Even now we offer no alibi for past delinquencies, but would merely call attention to the fact that we are gradually catching up—*surely*, if very slowly. We go so far as to predict that the May number, our printers permitting, will reach Detroit and other outlying districts in the month of May. In truth, we really appreciate the sarcastic comments of our Detroit correspondent because they are always accompanied by contributions. We have a number of critics who offer nothing but adverse criticism!

* * *

"Jist Roughly"

One of the members of our staff, a Scotch-Canadian by birth, was recently seized with a worthy ambition to become an American citizen. Because of his innate modesty, it is entirely possible that the subject of this sketch would be loath to have his name appear in print. In deference to this unexpressed wish, we omit specific mention of his name and for the purposes of this article designate him simply as "Mac."

While engaged, along with a lot of other miscellaneous Armenians, Portuguese, Greeks, Russians, etc., in filling out the usual inquisition blank, he noticed one, apparently an English-

speaking chap, who wore an extremely worried look. Finally the puzzled one turned to "Mac" and with a voice full of appeal and in rich Cockney accent, said:

"I sye, owld chappie, I'm a sea-goin' man and faarty-five years owld. Could you tell me the year in which I was baarn?"

Deeply engrossed in the mysteries of the questionnaire, "Mac" looked up with a blank stare.

Interpreting from the puzzled expression on "Mac's" face that he too had become hopelessly involved in the mathematical computation, the old salt sympathetically added:

"Jist roughly, y' know! Jist roughly!"

* * *

The JOURNAL is pleased to discover indications that it is not only received, but read by clients and friends as well as by members of the staff. The following letter in regard to the article "Stock Brokerage Accounts," which appeared in the March issue of the JOURNAL, was received from Mr. Herbert A. Shipman, formerly of the staff of the New York office, now a partner in the stock exchange firm of John Muir & Company. The letter is not only indicative of Mr. Shipman's personal interest in the subject matter of the JOURNAL, but also furnished the necessary stimulus to our brokerage specialists to give expression to their bit of constructive criticism which is reproduced in the accompanying pages.

Concerning the article in the March issue, Mr. Shipman says:

Mr. Clayton has evidently been misinformed on short sales. When a customer sells short he does not specify any period of time. If such a stipulation were made, what would a customer do in case of a "corner?"

As you are aware, stocks are sold "delayed delivery," but this is usually for a few days, and is an actual sale of stock owned by the customer but coming from out-of-town, or under similar conditions.

Incidentally, Mr. Shipman added a word of praise for one of the JOURNAL's most faithful contributors:

I hope you will continue sending the JOURNAL, for I enjoy reading it every time you are good enough to send it to me, particularly Bergman's effusions.

PHILADELPHIA

In lieu of office notes, Philadelphia contributes the following political outburst:

"Your call to Spruce 0640—the number has been changed to Rittenhouse 0116. One moment, please!"

Spruce 0640 is now no mo',
The A. T. & T. shot it,
So please affix 0116
To Rittenhouse, and you've got it.

This despot great of wide estate
Of poles and lines gigantic
It grows apace and of its grace
Hands us e'en tho' we're frantic.

A number new we can't eschew,
We've got to use, dog gone it!
Great Keller bold, thro' winters cold,
Who built careers upon it,

Why can't he make them leave us be
And not ring in these changes?
We're durned if we believe that he
Done all these stunts so dang'rous.

PITTSBURGH

The Pittsburgh office has been honored by visits from three of the partners—Mr. T. E. Ross, Mr. Pugh and Mr. Gee. Honorable mention is also due the following members of the staff of the other offices for appearing in the "Smoky City"—Messrs. Frank E. Hare, Fred Martin, Herman Oeschger, Leslie Carfrey, David Anderson, John Carson, H. H. Steinmeyer, all of the Philadelphia office, and Messrs. Burleson and Campbell of the Detroit office.

* * *

At a recent meeting of the Pittsburgh Chapter of the N. A. C. A. Mr. Marsh spoke on "Inventories as Affected by

Over - Absorbed and Under - Absorbed Burden."

Rumor has it that Marshall is about to join the benedicts. Congratulations!

SAN FRANCISCO

Physical Changes in the Office

Now that the sound of hammering and the smell of paint and varnish and the distracting sight of furniture out of place and the inevitable by-products of construction no longer make the day hideous and concentration upon work impossible, we look with pride upon the physical changes that have been made recently in the San Francisco office.

The changes included the construction of a Filing and Stationery room in front of the old file vaults. This room joins the former separate filing rooms known respectively as the Audit Files and the System Files, and provides the much needed additional space for files. It also greatly facilitates the handling of material in and out of the files and provides better control of both data and supplies.

It also provides a private sanctum for Miss Dahllof, with a grilled window and counter, through which papers and supplies are issued.

Another feature is the sound-proof stenographic room, with a comparing room, alongside, which centralizes all the operations involved in preparing reports.

The glassed partitions of the individual offices on the entire west side of the office were extended to the ceiling, which makes for privacy and less noise.

We hope, in the near future, to submit some pictures and a floor plan of the San Francisco Office, which will reveal what an attractive and efficiently arranged workshop it is.

In the meantime we may mention that the physical changes also included much

moving on the part of individuals. Mr. Buchanan is now alongside the rest of the tax department, instead of on the opposite side of the house, and Mrs. Farnsworth, our Secretary, and the accounting records have gone west—not south—and have moved across the office, displacing Mr. Kohnke, who immediately occupied the location just vacated by Mr. Cooper, who had seized the strategic position formerly occupied by the accounting office. It was very exciting and resembled a game of checkers played with desks, safes, chairs and similar dainty objects. All this is altogether fitting and proper, since spring is "Moving Time." It saves house cleaning, they say.

* * *

Signs of the City's Growth

The industrial department of the Chamber of Commerce tells us that 1,315 new enterprises have come into this city alone during the first three months of 1924. A manufacturer and exporter of tractors reports that the business for the first quarter exceeds the entire business transacted during 1921, with orders forcing production to a stiff pace.

A writer upon irrigation securities tells us of the progress of developing the back country to keep pace with this rapid growth of California's principal seaport. California is strong and its industrial advancement will soon astonish the remainder of the United States. The actual greatness of it has not been broadly grasped, although it is attracting new capital every week.

Forty thousand more persons filed Federal income tax returns in San Francisco this year than in 1923. This, according to John P. McLaughlin, Collector of Internal Revenue, is an increase of 20 per cent. over 1923, being the largest annual increase since Federal

income taxes were levied. McLaughlin's district includes the forty-eight counties of California north of Kern. Taxable individual returns in 1923 numbered 121,495, as against 142,033 for 1924.

Altogether 265,000 returns were filed this year, part of them being from persons who were not required to pay a tax. This total is divided into the following classes:

Individuals with incomes over \$15,000.	7,104
Individuals with incomes from \$5,000 to \$15,000.	62,199
Individuals with less than \$5,000 income	171,895
Partnerships.	11,500
Corporations.	8,952

* * *

Commendations

We had intended to submit some more letters of commendation from clients, but since our fellow correspondent from Detroit, in the March issue of the JOURNAL, called our attention to the fact that that would be "plagiarising" and further stated that "it is well known that New York is the only office that can do that," we are debating as to whether we shall again risk breaking in on New York's alleged monopoly of plagiarism.

We regret to have to report the death of Miss Rena A. McHale of the stenographic department, who was accidentally killed on April 14th while on her way to work, when a plank falling from a building under construction struck her upon the head.

Miss McHale had been with us about two months. Her sudden and untimely death was a great shock to us all and our heartfelt sympathy is extended to her family in their bereavement.

We were all pleasantly surprised to receive announcements to the effect that Mr. August J. Carson, of the System staff, was married on April 28th to Miss Emma G. Horstmann.

Mr. and Mrs. Carson intend to make their home in Oakland after June 1st, so here's where "A. J." joins the army of commuters.

We wish them every joy and happiness of life.

* * *

On the Wings of the Wind

We are interested in the announcement by the Air Mail Division of the Post Office Department that, effective July 1st, a 32-hour air mail service will be established between New York and San Francisco.

Thirty-two hours from the Statue of Liberty to the Golden Gate! Verily the world does move! Only a comparatively few years ago the Pony Express, which reduced the time from months to weeks, was the marvel of the country. Then came the railroads, and mail time across the continent could be counted in days. Can you realize that mail leaving here in the morning will soon be delivered in New York the next afternoon!

* * *

Mr. Robert Buchanan of the Tax Department gave a very interesting explanation of the main points involved in the California community property ruling as applied to Federal Income Taxes at a meeting of the San Francisco Chapter of the N. A. C. A., Friday evening, April 25th.

While we are not absolutely sure of it (from practical experience) we gathered that, theoretically, a Californian might divide his community income with his wife on the tax return without admitting her to full partnership in the income itself. Try to explain that to the wife

some evening when you feel like spending a nice quiet evening at home!

WASHINGTON

The Washington office has found that some complications have resulted from the change to daylight saving time in some of the other cities. We desire to state that, so far as this office is concerned, we are following the custom generally prevalent in our own city and are working on standard time. It means that we work a good deal longer at night than some of our offices do—even if they can't catch us quite as early in the morning!

The result at this end is something like this:

MR. HAYNES: "Miss Wadlin, see if you can get Howard on the 'phone."

MISS WADLIN: "Mr. Howard has gone for the day. Will you speak to some one else?"

MR. HAYNES: "I'll talk to Mrs. Vassar" (formerly Miss Kissinger).

MISS WADLIN: "Mrs. Vassar has gone for the day."

MR. HAYNES: "I'll speak to anyone but the office boy."

MISS WADLIN: "Who will talk on Beekman 8600? Oh, Mr. Bischoff! I'd love to talk to Mr. Bischoff."

MR. BISCHOFF: "The feeling is epidemic, Miss Wadlin."

* * *

The Washington office has almost come to feel that it can claim Mr. Lybrand as a resident partner. He and Mrs. Lybrand have left for the Pacific Coast, on a tour of the offices, and we miss his smiling presence at the end of each week.

* * *

Mr. FitzGerald has recently paid us his first visit in more than a year, and incidentally paid his maiden visit to the Congress of the United States. A representative from this office strayed into the gallery at the House of Representatives and found him gallantly trying to appear interested while a lone Member

(Continued on page 24)

Community Property in California

By ROBERT BUCHANAN

San Francisco Office

In a lengthy opinion, under date of March 8, 1924, the Attorney General of the United States has held that a wife in California has a "vested interest" in community property, rather than the interest of a mere "expectant heir." Following that opinion, the Treasury Department has amended Article 31, Regulations 62, to include California in the list of states where community income may be reported in separate returns for tax purposes.

From the standpoint of the accountant and of the business man, the matter of community property in California has two practical aspects:

- (1) What is the effect on income taxes?
- (2) What is the effect on the ownership and control of property and of the income therefrom?

It appears that the Californian may boast not only of his wonderful climate, the surpassing beauty of his scenery, but also of the wonder of his community property law.

Under that law the Treasury in effect says he can divide his income with his wife and thus considerably reduce the burden of the surtax.

Under that law, also, it appears that the Supreme Court of California has not accepted the "vested interest" theory with unanimity in its decisions and that, therefore, it may, when the question is squarely before it, hold that the wife has no vested interest in community property.

Thus the Californian may be able to eat his cake and have it, too. If this comes definitely to pass and the fact is heralded throughout the nation, we may expect a still greater influx of plutocrats

to California, "where the surtax lurketh not."

The opinion of the Attorney General is based on the decision of the Circuit Court of Appeals in *Blum v. Wardell*, 276 Fed. 226. Suit was brought to recover Federal estate taxes paid on the wife's share of the community property at the probate of the husband's estate. The Attorney General holds that the true rule is that announced in the *Blum* case that "*the wife has a greater interest than the mere possibility of an expectant heir.*"

The Attorney General reviews the California laws beginning with the Constitution adopted in 1849. Speaking of the wife's interest in the community, he says:

One line of California decisions has described her merely as an "heir expectant" of her husband. . . . But there is another course of judicial opinion . . . which recognizes her property interest in community gains.

These two theories have played back and forth across the field of judicial interpretation in California and no real analysis of the question can be made by ignoring the "score" of either.

Near the end of his opinion the Attorney General, referring to the decision of the California Supreme Court in *Roberts v. Wehmeyer* (218 Pac. 22), which was handed down since *Blum v. Wardell*, says that it "militantly upholds the heirship doctrine" and "repudiates the doctrine of her 'vested interest' on which the Federal Court's reasoning was based." Also that:

Judicial pronouncements, therefore, remain in substantially the same divided camps in California now as they were in 1920 when the Federal Court decided the *Blum* case. . . .

In an address before the Bankers Chapter of the San Francisco Associa-

tion of Credit Men, on August 23, 1923, Alexander D. Keyes, President of the Humboldt Savings Bank, speaking of the 1923 amendment with reference to the power of the wife to dispose by will of one-half of the community property, stated:

Of course, if the new law is construed to give the wife *an estate* in the community property, then the estate thus conferred upon her will naturally be liable for the payment of her debts, but if it should be held that the wife has *not an estate in the community property but only a power to dispose of it by will* then I shall feel far from certain that the so-called wife's half of the community property is liable for the debts of the wife contracted after marriage. Incidentally, it may be proper to say at this point that people often speak of the wife's half of the community property. I have used that term myself for want of a better term to refer to that half which the law permits her to dispose of by will. But in truth the law does not anywhere state that the wife owns half of the community property. No doubt there are statutes, for instance, section 1723 of the Code of Civil Procedure, which speaks of community property as the community property of both spouses, but these statutes, which appear to refer to an estate in the community property belonging to the wife, have been in force for a long time, and yet the Supreme Court has recently held that as late as 1917 the wife had no estate or interest in the community property.

Mr. Keyes, in the same address, gives a very clear exposition of the effect of the 1923 amendment from a credit standpoint and concludes that:

What is now community property will not be subject to the provisions of the new law. In course of time husbands will accumulate property acquired after the 16th of August, 1923, and that property, if the law is constitutional, may be brought under its operation and then that husband's creditors will be affected in two ways:

First: By the uncertainty and inconvenience arising from a part—possibly half—of the assets of a living debtor being partly placed under the control of an executor and a court where the assets that should be used to pay the debts can only be reached by the slow and technical procedure of the probate law.

Secondly: By the ultimate withdrawal of a part and possibly half of the capital of a living debtor which portion of the capital would be turned over to someone else.

Sometimes this withdrawal of capital from an active business will seriously cripple the business

by diminishing the capital of the firm; sometimes the fact that a stranger has succeeded to an interest in the business will bring into the management of the business an undesirable person. At all events this change of the personnel of the firm may in some cases cause serious injury to the firm and consequently to its creditors.

Heretofore creditors were obliged to consider the possibility of the debtor's death. Hereafter they may be called upon to consider the possible effect of the death of his wife. Of course, if the wife dies without leaving a will, her death will have no effect on the position of the creditor, but the possibility of her death and the possibility of her making a will disposing of the community property may injuriously affect, to a limited extent, the creditors of a business.

It will thus be seen that, apart from Federal income taxes, many of the perplexing problems under the community property law will be settled only when we have a definite decision by the California Supreme Court as to whether or not the wife has a "vested interest" in one-half of the community property.

Another point on which opinions are divided is whether personal property acquired by the husband outside California becomes community property when he moves into this state. For example, a man living in Illinois, say, acquires since marriage \$100,000 which he invests in U. S. Steel stock. If he had lived in California such property, acquired with community earnings, would be community property. In Illinois it is the husband's separate property. Assume, now he moved to California before 1923. Does the \$100,000 become community property the moment he takes up his residence in this state? That has been said to be the intent of the amendment of 1923. Others hold that it applies only after the taking effect of the amendment—in other words that it has no retroactive effect.

Thus in any consideration of community property we have to bear in mind the two aspects mentioned in the beginning, viz.: Federal income taxes,

and the view of the State courts with reference to control, disposition by will, liability to creditors, and other factors.

While from a pure cost-finding standpoint the question of community property does not loom large, I take it that cost men are presumed to have a basic knowledge of financial and management problems. Certainly the peculiar status of ownership and management under the California community property law is bound to affect many businesses, and a statement of the problem may help to point a way to its solution.

A summary of what constitutes income from community and separate property, respectively, and the deductions applicable thereto follows:

Community Income

1. Rents, issues and profits from community real estate, regardless of place of domicile:
 - (a) Where the real estate is situated in California.
 - (b) Where the real estate is situated in a *community property state* other than California. (These states include: Arizona, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington.)*
2. The earnings of the husband in salary, wages, fees, etc., unless divorced.
3. The earnings of the wife if living with her husband, i.e. not separated.
4. Income from money borrowed by either husband or wife on community credit or security.
5. Income from investments purchased with money borrowed as in (4) above.
6. Income, issues and profits from community personal property acquired while domiciled in California. (Includes all personal property representing accumulations of community income.)
7. Income from personal property acquired while domiciled outside of California, which property if acquired while domiciled in California would have been community property, now owned by persons domiciled in California. Applies after June 14, 1923.
8. That portion of profits derived from a partnership which can be allocated to personal activity, ability and capacity and

not from capital investment of separate property.

9. Income or profits derived from contracts or choses in action which are not separate property.

Separate Income

1. Rents, issues and profits from all property owned before marriage by either husband or wife.
2. Rents, issues and profits from all property acquired after marriage by gift, bequest, devise or descent by either husband or wife.
3. The earnings and accumulations of the wife, and her minor children living with her or in her custody, while she is living separate from her husband.
4. Income from real estate acquired after marriage by the wife which cannot be identified by conclusive evidence as community property.
5. Income from community property which has been the subject of gift between husband and wife. For example a husband or wife can make a gift to the other of his or her half of the community property.
6. Earnings of wife where husband has expressly agreed that she may accumulate them as her separate property.
7. Income from property purchased with earnings accumulated as in (6).
8. Rents, issues and profits from property purchased by wife with money borrowed on her separate credit with husband's express consent.
9. Profits from a business carried on by a married woman in her own name as a sole trader with the permission of her husband.

Community Deductions

1. Taxes on community property.
2. Insurance on community business property.
3. Business expenses incurred in carrying on a community business.
4. Losses on community property by fire, storm, etc.
5. Interest paid on money borrowed, unless borrowed on separate credit for separate use.
6. Bad debts owing directly to the community.
7. Contributions paid directly from community income.
8. Losses on sale of community assets.
9. Other deductions authorized by law and directly related to community property.

Separate Deductions

1. Taxes on separate property.
2. Insurance on separate business property.

*Rents, issues and profits from real estate situated in any other state are separate income regardless of where the owner lives.

3. Business losses incurred in carrying on a separate business.
4. Losses on separate property by fire, storm, etc.
5. Interest paid on money borrowed on separate credit for separate use.
6. Bad debts unless they are owing directly to the community.
7. Contributions unless made from community income.
8. Losses on the sale of separate assets.
9. Other deductions authorized by law and directly related to separate property.

It should be noted in regard to exemptions:

1. Personal exemption (\$2,000 or \$2,500) may be taken by either or divided between them.
2. Exemption for dependents (\$400 each) must be taken by one providing the chief support or may be taken by either if they contribute equally to support, but cannot be divided.
3. Each spouse is entitled to the full exemption on Liberty Bond interest.
4. Each spouse is entitled to \$300 exemption of income from building and loan associations.

In conclusion, California may be deemed to offer one more inducement to the man of wealth to migrate hither if he can divide with his wife for surtax purposes and not divide for purposes of control—an Indian gift truly!

Office Notes

(Continued from page 20)

tried to get up a little opposition to the Child Labor amendment. The disorder seemed a little worse than usual, and we fear his impression was that our standards of oratory have fallen to a low ebb.

* * *

Mr. and Mrs. Haynes have just issued invitations to the office staff for a party at Columbia Country Club on Thursday evening, May 8th. It is confidently expected that Mr. and Mrs. Henderson will be present, as well as one or two other representatives from out of the city. We extended a very special invitation to the Editor of the JOURNAL, but we think he suspected us of wanting some publicity we didn't give to ourselves—anyway, he turned us down.

The Revenue Act of 1924

(Continued from page 11)

Extension of Time for Refunds

The present session of Congress has succeeded already in enacting one piece of tax legislation, passed March 13, 1924, extending the time for claims for refund for 1917 and 1918. If a 1917 waiver was filed within five years from the time the return for 1917 was due, the taxpayer has until April 1, 1925, for filing a claim for refund or until two years after the tax was paid (whichever comes later). For 1918, if a waiver has been filed or is filed on or before June 15, 1924, there is also an extension to April 1, 1925, or until two years from the time the tax was paid (whichever is later) for filing claim for refund of 1918 taxes.

It must be borne in mind that none of the changes described in the foregoing paragraphs, except the last, are law, and nobody knows which of them will be law. It does not seem wise to go far in shaping the policies of taxpayers in anticipation of changes in the law until it is more evident what such changes will be, but when the law is actually amended, it will clearly be necessary, particularly for individual taxpayers, to restudy the whole tax situation to find out what helpful changes in their investments, manner of conducting business, etc., can be made. It is very evident, particularly from the provisions of Sections 202 to 204 of the new bill, dealing with determination of gains, that the much desired simplification of the law is not the thing uppermost in the minds of the framers of the bill and that many people inside and outside the Treasury Department will spend weary hours trying to find out just what certain provisions of any new law passed may mean.

